No. 92-1151

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In The Supreme Court Of The United States

OCTOBER TERM, 1992

UNSECURED CREDITORS' COMMITTEE OF C-T OF VIRGINIA, INCORPORATED,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

I. WHAT IS THE PROPER STANDARD TO DETERMINE WHETHER A GOVERNMENTAL EXACTION IS A TAX, THE CLAIM FOR WHICH IS ENTITLED TO PRIORITY IN BANKRUPTCY UNDER 11 U.S.C. § 507(a)(7)(E), OR A PENALTY, THE CLAIM FOR WHICH MAY NOT BE ENTITLED TO PRIORITY?

II. IS THE GOVERNMENT'S CLAIM UNDER SECTION 4980 OF THE INTERNAL REVENUE CODE FOR AN "EXCISE TAX" ON THE REVERSION OF EMPLOYEE PENSION FUNDS TO THE EMPLOYER ENTITLED TO PRIORITY AS AN "TAX" UNDER 11 U.S.C. § 507(a)(7)(E)?

LIST OF PARTIES AND RULE 29.1 STATEMENT

The Petitioner and Respondent named above in the case caption were all of the parties before the United States Court of Appeals for the Fourth Circuit in the case below. No parent or subsidiary company is required to be listed under Supreme Court Rule 29.1.

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No._____

IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1992

UNSECURED CREDITORS' COMMITTEE OF C-T OF VIRGINIA, INCORPORATED,
Petitioner.

v.

UNITED STATES OF AMERICA,
Respondent,

Petition for Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

The Unsecured Creditors' Committee of C-T of Virginia, Incorporated, request that this Court issue a writ of certiorari to the United States Court of Appeals for the Fourth Circuit to review that Court's final judgment filed on October 2, 1992.

OPINIONS BELOW

The United States Court of Appeals for the Fourth Circuit's opinion below is officially reported at 977 F.2d 137 (4th Cir. 1992). A-1[1] In that opinion, the fourth circuit affirmed an order of the United States District Court for the Western District of Virginia, Lynchburg Division, which is reported at 135 B.R. 501 (W.D. Va. 1991). A-18. The district court's order had reversed a decision and order rendered by the United States Bankruptcy Court for the Western District of Virginia, Lynchburg Division, which is reported at 128 B.R. 628 (Bankr. W.D. Va. 1991). A-29.

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[1]The Appendix to this Petition is cited as "A-__."

JURISDICTIONAL STATEMENT

The decision of the United States Court of Appeals for the Fourth Circuit in this case was decided and filed on October 2, 1992. This Court has jurisdiction to review the final judgment of the court of appeals by writ of certiorari pursuant to Section 1254(1) of Title 28, United States Code. 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS AT ISSUE

This case principally requires interpretation and application of Sections 507(a)(7)(E) (as amended in 1984)[2] of the Bankruptcy Code, 11 U.S.C.

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[2]The priority section originally applicable to this dispute was Section 507(a)(6) of the Bankruptcy Code. Section 507(a)(6) was redesignated as Section 507(a)(7) by Congress in 1984. See Bankruptcy Amendments and Federal Judgeship Act of 1984, §§ 350 & 553, Pub. L. No. 98-353, 98 Stat. 333, 358,

§§ 507(a)(7)(E), and Section 4980 of the Internal Revenue Code (I.R.C.), 26 U.S.C. § 4980 (as amended in 1986). Section 507(a)(7)(E) states, in pertinent part:

> (a) The following expenses and claims have priority in the following order:
>
> . . .
>
> (7) Seventh, allowed unsecured claims of governmental units, only to the extent that such claims are for--
>
> . . .
>
> (E) an excise tax on--
>
> (i) a transaction occurring before the date of the filing of the petition for which a return, if required, is last due, under applicable law or under any extension, after three years before the date of the filing of the petition; or
>
> (ii) if a return is not

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392. For ease of reference, this Petition will cite to the currently applicable provisions of Section 507(a)(7).

> required, a transaction occurring during the three years immediately preceding the date of the filing of the petition....

11 U.S.C. § 507(a)(7)(E).

I.R.C. (26 U.S.C.) § 4980 reads, in pertinent part:

> (a) There is hereby imposed a tax of 10 percent of the amount of any employer reversion from a qualified plan.
>
> (b) The tax imposed by subsection (a) shall be paid by the employer maintaining the plan.
>
> (c) For purposes of this section--
>
> > (1) The term "qualified plan" means any plan meeting the requirements of section 401(a) or 403(a), other than-
> >
> > > (A) a plan maintained by an employer if such employer has, at all times, been exempt from tax under subtitle A,
> > >
> > > (B) a governmental plan....
> >
> > Such term shall include any plan which, at any time, has been determined by the

> Secretary to be a qualified plan.
>
> (2) The term "employer reversion" means the amount of cash and the fair market value of other property received (directly or indirectly) by an employer from the qualified plan.

I.R.C. § 4980.

Section 4980 was amended in 1988 to increase the 10 percent tax to 15 percent, see Pub.L. No. 100-647, 102 Stat. 3704, and amended again in 1990 to increase the tax to 20 percent, see Pub.L. No. 101-508, 104 Stat. 1388 [1432].

STATEMENT OF THE CASE

Craddock-Terry Shoe Corporation, the debtor, filed a petition for relief under Chapter 11, Title 11, United States Code (the Bankruptcy Code of 1979) on October 21, 1987. During the

pendency of the bankruptcy case, the name of the debtor was changed to C-T of Virginia, Inc.

The Internal Revenue Service (the "IRS") filed a proof of claim and an amended claim in the bankruptcy case for Internal Revenue taxes which included an unsecured priority claim under 11 U.S.C. § 507(a)(7) for "retirement plan" (pension reversion) tax for the period ended December 31, 1986 in the amount of $285,443.35 and interest to the date of the petition in the amount of $1,788.37

The Unsecured Creditors Committee of C-T of Virginia, Inc. (the "Committee") filed an objection to the proofs of claim filed by the IRS, in which the claim for "retirement plan" tax was objected to on the grounds that it was a "penalty not entitled to priority."

A hearing was held on January 4, 1991 before the U.S. Bankruptcy Court for the Western District of Virginia on the Committee's objection. At the hearing, all objections to the claims of the IRS, except the claim for "retirement plan" tax, were resolved by agreement and stipulation. The Committee stipulated that the debtor, within three years prior to commencement of the bankruptcy case, had terminated a qualified pension plan as defined in I.R.C. § 4980(c)(1); when the plan was terminated, the debtor received an "employer reversion" as defined in I.R.C. § 4980(c)(2); and the amount of tax claimed by the IRS to be due under I.R.C. § 4980 was correctly computed.

On May 3, 1991, the Bankruptcy Court entered an Order based upon an extensive Memorandum Opinion determining

that the $285,443.35 plus $1,788.37 pre-petition interest claimed as an unsecured priority claim by the IRS was not entitled to priority under 11 U.S.C. §§ 507(a)(7)(E) or (G). In re C-T of Va., Inc., 128 B.R. 628 (Bankr. W.D. Va. 1991) (A-29).

The IRS filed a timely Notice of Appeal to the United States District Court for the Western District of Virginia from the final Order of the Bankruptcy Court entered May 3, 1991. By Order and Memorandum Opinion entered October 30, 1991, the U.S. District Court for the Western District of Virginia reversed the decision of the Bankruptcy Court "as to its holding that 26 I.R.C. [sic U.S.C.] § 4980 constitutes a penalty for purposes of priority under 11 U.S.C. § 507(a)(7)(E). The district court did not reverse the

finding of the bankruptcy court that the I.R.S. claim was not entitled to priority under 11 U.S.C. § 507(a)(7)(G). In re C-T of Va., Inc., 135 B.R. 501 (W.D. Va. 1991) (A-18).

The Committee appealed the District Court Order to the United States Court of Appeals for the Fourth Circuit. On October 2, 1992, the court of appeals affirmed the decision of the district court, finding that the tax imposed by I.R.C. § 4980 was not entitled to priority under 11 U.S.C. § 507(a)(7)(G), but was a priority claim under 11 U.S.C. § 507(a)(7)(E). In re C-T of Va., Inc., 977 F.2d 137 (4th Cir. 1992)(A-1).

ARGUMENT

THE COURT OF APPEALS ERRED IN DETERMINING THAT I.R.C. § 4980 IMPOSES A TAX ENTITLED TO PRIORITY UNDER 11 U.S.C. § 507(a)(7)(E).

A. I.R.C. § 4980 Is Not A Tax Entitled To Priority Under 11 U.S.C. § 507(a)(7)(E).

The purpose of the Bankruptcy Code's limitation on priority of penalties is to prevent the punishment of innocent creditors of a bankrupt for actions of the bankrupt. Simonson v. Grandquist, 369 U.S. 38, 40 (1962); In re Unified Control Sys., Inc., 586 F.2d 1036 (5th Cir. 1978).

The Congressional intent to deny priority status to "tax penalties" is reflected in 11 U.S.C. § 726(a)(4). "Paragraph (4) provides that punitive penalties, including prepetition tax penalties, are subordinated to the

payment of all classes of claims...." Senate Report No. 989, 95th Cong., 2d Sess. 96-97 (1978).

Taxes entitled to priority in bankruptcy are "those pecuniary burdens laid upon individuals or their property, regardless of their consent, for the purposes of defraying expenses of government or undertakings authorized by it." City of New York v. Feiring, 313 U.S. 283, 285 (1941).

A four part test has evolved for determining whether a claim qualifies under this definition. A "tax" for bankruptcy law purposes is:

(a) An involuntary pecuniary burden, regardless of name, laid upon individuals or property;

(b) Imposed by, or under authority of the legislature;

(c) For public purposes, including the purposes

> of defraying expenses of government or undertakings authorized by it; and
>
> (d) Under the police or taxing power of the [governmental unit].

In re Lorber Indus. of Cal., Inc., 675 F.2d 1062, 1066 (9th Cir. 1982).

When a governmental levy designated as a tax is in bankruptcy sought to be treated as a penalty, the determinative question is whether the third part of the test is met. United States v. Dumler (In re Cassidy), ___ F.2d ___, 1992 WL 359741, 359743 (10th Cir. Dec. 7, 1992); In re Airlift Int'l, Inc., 97 B.R. 664, 669 (Bankr. S.D. Fla. 1989), aff'd, 120 B.R. 597 (S.D. Fla. 1990).

The point is that "punitive or penalty damage claims are imposed to deter future wrongdoing...." Airlift Int'l, Inc., 97 B.R. at 670. Taxes will be considered penalties where they are

"exactions ... intended to curb the described conduct through pecuniary punishment." In re Unified Control Sys., Inc., 586 F.2d 1036, 1039 (5th Cir. 1978). See also United States v. Dumler, 1992 WL 359741. Such an imposition is a penalty where it "actually regulates conduct and is not an income producing measure meriting preferential treatment in bankruptcy." Latterman v. United States, 691 F. Supp. 893, 897, (W.D. Pa. 1988), aff'd, 872 F.2d 564 (3d Cir. 1989).

The Court of Appeals for the Fourth Circuit in the decision below adopted the finding of the district court that the claim of the IRS in this case is for an excise tax in part because of its grouping with other taxes designated as excise taxes, including I.R.C. "§ 4941 et seq. (tax on undistributed income,

speculative investments, etc. of private foundations)". A-14. Priority claims for excise taxes under I.R.C. §§ 4941 and 4944 have been held to be penalties under Section 57j (11 U.S.C. § 93j) of the Bankruptcy Act. In re Kline, 403 F. Supp. 974 (D. Md. 1975), aff'd, 547 F.2d 823 (4th Cir. 1977); In re Unified Control Sys,, Inc., 586 F.2d 1036 (5th Cir. 1978).

I.R.C. § 4980 is comparable to portions of I.R.C. § 72 which, by its terms, imposes a 10% "penalty" for premature distributions from annuity contracts, I.R.C. § 72(q), and a 10% "additional tax" on early distributions from qualified retirement plans, § 72(t), and taxable distributions from modified endowment contracts, § 72(v). The 10% penalty or additional tax operates to increase the taxpayer's tax

in the year of receipt by an amount equal to 10% of the portion of the amount received which is includable in the taxpayer's gross income.

The Senate explanation of I.R.C. § 72(t) as amended by Public Law 99-514, October 22, 1986, gave as the reason for the enactment of the "additional tax" that "the present-law level of the additional income tax appears in many instances to be an insufficient deterrent to the use of retirement funds for non-retirement purposes...." 2 Fed. Taxes (P-H) ¶ 7732.18, at p. 7790.15 (1989).

On December 7, 1992 the U.S. Court of Appeals for the Tenth Circuit affirmed decisions of the District Court and Bankruptcy Court of the Western District of Colorado finding I.R.C. § 72(t) a penalty and not entitled to

priority in bankruptcy. United States v. Dumler, ___ F.2d ____, 1992 WL 359741.

In Dumler, the court of appeals found the legislative history of I.R.C. § 72(t) indicated multiple intentions of Congress, including the purposes of preventing "retirement plans from being treated as savings accounts" and deterring "the use of retirement funds for nonretirement purposes", and determined that the issue of priority should then be decided on the basis of bankruptcy policy. United States v. Dumler, 1992 WL at 359743.

The court then adopted the policy stated in Simonson v. Grandquist, 369 U.S. 38 (1962) and In re Unified Control Sys., Inc., 586 F.2d 1036 (5th Cir. 1978) that "The policy of protecting unsecured creditors from the bad conduct

of the debtor is best implemented by avoiding burdening the claims of unsecured creditors with penalties that are imposed upon the debtor." United States v. Dumler, 1992 WL at 359744.

Like I.R.C. § 72(t), the arbitrary percentage of a reversion levied by I.R.C. § 4980 does not relate to any ascertainable benefit to the taxpayer or burden to the government which its initial legislative history suggests it seeks to recoup, indicating that this "excise tax" is not a tax, but a penalty.

The declared purpose of I.R.C. § 4980 has to do with recapturing "unintended tax advantages," reversing "inappropriate tax-favored treatment," and the "tax" applies only where the funds are not used for the desired purposes. The statute clearly seeks to

affect conduct. It does not by its terms seek to raise revenue -- at the most, "the government's interest in the revenue is insufficiently related to income generation" for this to be considered a tax for purposes of granting the claim priority over the unsecured creditors. Latterman v. United States, 691 F. Supp. 893, 897 (W.D. Pa. 1985), aff'd 872 F.2d 564 (3d Cir. 1989) (distinguishing the bankruptcy cases cited from that case's tax law context).

B. I.R.C. § 4980 Imposes A Penalty.

I.R.C. § 4980 was enacted as part of the Tax Reform Act of 1986, P.L. 99-514, § 1132. The Bankruptcy Court for the Western District of Virginia stated in its opinion:

> Nothing in the legislative history of 26 U.S.C. § 4980 specifically addresses the penalty versus excise tax question that is before the court. In general, however, that history and other legal commentary indicates that the purpose of section 4980 was and is to discourage employers from terminating overfunded retirement plans and using the excess funds for purposes other than employee retirement, health or other benefits.

In re C-T of Va,, Inc., 128 B.R. 628 (Bankr. W.D. Va. 1991) (A-27).

The General Explanation of the Tax Reform Act of 1986 (HR 3838), prepared by the Staff of the Joint Committee on Taxation and released May 7, 1987, pages 750-54, at page 751, and the House Ways and Means Committee Report on HR 3838, "Tax Reform Act of 1985", Part II, released Dec. 9, 1985, pp. 756-7, at page 756, both indicate the purpose of I.R.C. § 4980 as restricting the use of

retirement plans to retirement income.

The I.R.C. § 4980 reversion tax is not imposed upon "any amount distributed to any employee (or beneficiary), if such amount could have been distributed before the termination of the plan without violating the plan qualification requirements." House Report on HR 3838, pp. 757. Also, the tax does not apply to the extent the employer transfers the reversion to an employee stock-ownership plan (ESOP), because

> [T]he Committee believes that it is appropriate to provide an exception to this tax in the case of certain transfers of excess assets to an ESOP (to the extent that such assets are invested in employer securities) in order to encourage the greater establishment of such plans to promote employee stock ownership.

S. Rep. No. 313, 99th Cong., 1st Sess., Tax Reform Act of 1986, Senate Finance

Committee Report (To Accompany H.R. 3838), Tax Reform Act of 1986, May 29, 1986, pp. 635-8.

The purpose of I.R.C. § 4980 was also evident at its origin in the Treasury Department's report to President Reagan on "Tax Reform for Fairness, Simplicity, and Economic Growth -- Volume 2 --General Explanation of the Treasury Department Proposals", November 27, 1984. Chapter 17.05, states as follows:

> The additional tax on plan assets reverting to an employer would parallel the additional tax on early distributions to individuals from tax-favored retirement plans. The additional tax also would be an effective and administratively simple deterrent to transactions designed merely to draw assets from an ongoing defined benefit plan without encouraging employers to substitute defined contribution plans for their terminating defined benefit

plans." [Emphasis supplied.]

The comments of the executive department regarding proposed legislation are a valid part of the legislative history to be considered in construing the statute. Johnson v. Southern Pac. Co., 196 U.S. 1, 19, 20 (1904).

The "sanction" aspect of I.R.C. § 4980 carried through to the Technical and Miscellaneous Revenue Act of 1988 ("TAMRA"), P.L. 100-647, which increased the rate of the reversion tax from 10% to 15%. The increase derived from the Senate Finance Committee's proposal for an amendment which would have temporarily (from mid-1988 through May 1, 1989) increasing the reversion tax rate from ten percent under the 1986 law to sixty percent 60%. The final legislative compromise was to make the increase less, but permanent.

Conference Report/Statement of the Managers (October 24, 1988), p. 177. See 1991 Stand. Fed. Tax Rep. (CCH) ¶ 35,960.

The tax rate imposed by I.R.C. § 4980 was again increased from 15 percent to 20 percent by the Revenue Reconciliation Act of 1990 (I.R.C. § 4980(a)(1990)) which was passed by Congress on October 27, 1990 and signed by the President on November 5, 1990, with a provision for a 50 percent rate if the employer does not establish a qualified replacement plan or provide minimum increases in other employer benefits (I.R.C. § 4980(d)(1990)). See Extra Edition No. 48, Stand. Fed. Tax Rep. ¶ 5231 (November 6, 1990). I.R.C. § 4980(d)(6) as amended in 1990, exempts an employer which was a debtor under Chapter 7 (but evidently not Chapter

11), Title 11, U.S.C. at the time of plan termination.

The focus of I.R.C. § 4980 has been and continues to be primarily to deter employers from "cashing out" overfunded pension plans and using the reversion to the employer for purposes other than employee benefits. As noted, in 1990, Congress increased the maximum "penalty" on such a reversion to 50%, in addition to the ordinary income tax on the reversion. The Revenue Reconciliation Act of 1990, Pub. L. 101-508, 104 Stat. 1388 § 12002(a). The House Report on this amendment acknowledged that the congressional purpose of I.R.C. § 4980 was "to limit the tax incentives available to an employer that maintains a pension plan" and "that contributions to such plans, as well as the earnings on such contributions, are intended to

provide for the pension benefits of plan participants." H. Rep. No. 881, 101st Cong., 691.

House Report No. 881 further indicates that the basis for I.R.C. § 4980 and the reasons for the 1990 changes were: (1) to limit tax incentives; (2) to provide for pension benefits of participants; (3) to recapture tax benefits and; (4) to provide an incentive to maintain a retirement plan following termination or increase benefits to participants before termination. H. Rep. No. 881 at 691-92.

The Staff of the Joint Committee on Taxation has recently characterized I.R.C. § 4980 and related sections, including those dealing with qualified pension plans (§§ 4971 through 4979) as "'Penalty' excise taxes". Joint Committee on Taxation, Schedule of

Present Federal Excise Taxes (as of January 1, 1992) (JCS-7-92) March 27, 1992., pp. 21-27.

Under the standards properly applicable to the questions before the courts below in the instant case, I.R.C. § 4980 must fail the third prong of the test for determining a "tax" for bankruptcy priority purposes. The clear focus of I.R.C. § 4980 has been and is the regulation of conduct, and it does not merit priority protection at the expense of the general creditors of the bankrupt employer.

C. There is a conflict among United States courts of appeals as to the application of 11 U.S.C. Section 507(a)(7)(E) which should be resolved by this Court.

This case turns on the standard to be applied in determining whether a governmental unit's unsecured bankruptcy

claim is a "tax" entitled to priority under 11 U.S.C. Section 507(a)(7)(E) or a "penalty" which, unless it is a "pecuniary loss" penalty, will be denied priority and may be subject to subordination. The standard as to what is a "tax," derived from this Court's rulings in City of New York v. Feiring, 313 U.S. 283 (1941) and New Jersey v. Anderson, 203 U.S. 483 (1906), and illustrated (in its reverse application of treating as a tax that which is designated a penalty) in United States v. Sotelo, 436 U.S. 268 (1978), is now substantially differently applied, or not applied, by several United States courts of appeals, and in the present context has also been applied inconsistently within a single court of appeals, as to the priority treatment in bankruptcy of claims for the same and

similar governmental impositions. The same and similar "taxes" are given bankruptcy priority by one court of appeals and denied priority by another court of appeals.

In the instant case, each of the courts below sought to determine whether the governmental imposition under I.R.C. Section 4980, the tax on pension reversions, was to be treated as an "excise tax" under 11 U.S.C. Section 507(a)(7)(E), in which case the claim for the imposition would have priority status, or as a "penalty" (the determination having been made that in such event the claim would not have priority because it was not a "pecuniary loss penalty" under 11 U.S.C. Section 507(a)(7)(G)). The district court and the court of appeals below, in seeking to decide these questions, were prepared

to consider whether what was called a "tax" might be a "penalty," but apparently intended to restrict the penalty classification to impositions which met a definition of a "punitive type of penalty" evidently thought to be derived from In re Kline, 403 F.Supp. 974, 978 (D. Md. 1975), aff'd. per curiam ("We are unable to fault [the district court opinion] or improve upon it, and adopt it as our own."), 547 F.2d 823 (4th Cir. 1977). In re C-T of Virginia, 91-0026-L, at 4 (A-25); In re C-T of Virginia, ____ F.2d at ____ (A-10).

The actual standard utilized by the courts below must clearly have been something else again, since the district court below determined that I.R.C. § 4980 was an excise tax and not a penalty by analogizing § 4980 to a list

of other taxes "levied against conduct", including I.R.C. § 4941 et seq., which it indicated were not to be considered penalties and therefore were to be afforded priority status, 91-0026-L, at 4 (A-23). The court of appeals adopted the same rationale applied by the district court, ____ F.2d at ____ (A-12-3). But, I.R.C. § 4941 was precisely the "tax" held to be a penalty, and denied priority status, by the fourth circuit in In re Kline, 547 F.2d 823. The impositions under I.R.C. Section 4941 were also held to be a penalty, and denied priority status, by the fifth circuit in In re Unified Control Sys., Inc., 586 F.2d 1036 (5th Cir. 1978).

However, the opinions of the district court and the circuit court in the instant case fail to either distinguish or reject Kline or Unified

Control Systems. Both of those earlier decisions clearly reached results contrary to the decisions below in the instant case, and did so by determining that the impositions in question were designed to "curb the described conduct," Unified Control, 586 F.2d, 1039, not, as the court of appeals below would require, by application of a rule that unless the impositions were a "punitive type of penalty," they are taxes. Thus, the imposition under I.R.C. § 4980 was held in the instant case to be a tax and not a penalty, by purporting to apply a standard which on its face differs from that of other circuits. While applying that standard, the courts below indicated that impositions under I.R.C. § 4980 should be treated as taxes, but the other impositions to which § 4980 has been

compared have in fact been treated as penalties in the decisions claimed to give rise to the standard claimed to be applied.

Yet another approach has emerged from the Sixth Circuit, whose decision in In re Mansfield Tire & Rubber Co., 942 F.2d 1055 (6th Cir. 1991), cert. denied, Krugliak v. United States, 112 S. Ct. 1165 (1992), stands for the proposition that while state and local exactions might be reviewed to determine whether what was called a tax should be treated as a tax for bankruptcy priority purposes, federal impositions would be differently treated, since what Congress called a tax should be treated as a tax for this purpose. Mansfield dealt with whether the impositions under I.R.C. § 4971, levied on the underfunding of a pension plan, were "excise taxes." The

sixth circuit held that they were, on the basis that "we will not independently decide whether Congress meant 'excise tax' when it said 'excise tax.'" 942 F.2d, 1059. [While I.R.C. § 4971 itself refers to its imposition as a "tax", it is open to question whether Congress ever "said 'excise tax,'" since that designation was derived, 942 F.2d, 1057, from the circumstance that Section 4971 is part of Subtitle D of the Internal Revenue Code and the fact that the heading to Subtitle D refers to "Miscellaneous Excise Taxes" -- notwithstanding that I.R.C. Section 7806(b) expressly bans any "inference, implication, or presumption of legislative construction" from such a circumstance.]

The sixth circuit expressly declared that In re Kline,

and In re Unified Control Sys., Inc., had been "wrongly decided". 942 F.2d, 1060. The tenth circuit has, within the last several weeks, in turn declared, as to these questions, that "We must reject Mansfield and follow the reasoning of In re Unified Control Systems, Inc." United States v. Dumler (In re Cassidy), ___ F.2d ___, 1992 WL 359741, 359743 (10th Cir. Dec. 7, 1992). Dumler dealt with the bankruptcy priority status of the "additional tax" imposed under I.R.C. § 72(t).

The intent and application of I.R.C. § 4980 [the imposition involved in the instant case] and § 72(t) [the imposition involved in Dumler] are virtually identical. I.R.C. § 4980 applies to the reversion of funds to an employer upon the termination of a qualified plan, where such overfunding

amounts are retained by the employer for non-retirement purposes, and § 72(t) applies to the employee who makes an early withdrawal of vested benefits, thus also for non-retirement purposes. (See the description of proposed § 4980 in the Treasury Department's report to President Reagan on "Tax Reform for Fairness, Simplicity, and Economic Growth -- Volume 2 --General Explanation of the Treasury Department Proposals", November 27, 1984. Chapter 17.05.) Subsequent to the decision of the fourth circuit in this case, the tenth circuit held that the "additional tax" imposed by I.R.C. § 72(t) was a penalty, not entitled to priority in bankruptcy. United States v. Dumler, 1992 WL 359741.

The decision of the fourth circuit in the instant case creates a conflict with its decision in Kline, with the

fifth circuit decision in Unified Control Systems, and with the decision of the tenth circuit in Dumler. The decision of the sixth circuit in Mansfield is distinct from all of these either in approach to or result with respect to undistinguishable issues. The decisions all purport to address the application to these questions of tenets derived from this Court's decisions in Feiring and Anderson, but questions of whether those tenets are to be applied, and how they are to be applied, are decided inconsistently.

The issues raised in these cases are critical to the administration of the Bankruptcy Code, and have not been directly addressed by this Court since the adoption of the Bankruptcy Code. Therefore, this Court should resolve the existing conflicts between the decision

and approach to the questions at issue in the instant case and the prior decision and approach of the fourth circuit and of the cited decisions of the fifth and tenth circuits and, of necessity, that of the sixth circuit.

RELIEF REQUESTED

The standards applied, and the application of those standards, to the questions presented by the instant case by the courts below, are in conflict with the decisions of other courts of appeals and are improper under the decisions of this Court. The proper and consistent administration of the Bankruptcy Code requires the determination of the standards to be applied to establish whether governmental exactions should be granted priority status as "taxes" or made

subject to the rules governing "penalties" which may be denied priority under certain circumstances. The Petitioner respectfully requests this Court to grant certiorari to review the erroneous decision of the United States Court of Appeals for the Fourth Circuit, and to resolve the conflict among the several courts of appeals on the issue.

Respectfully submitted,

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ATTORNEYS FOR PETITIONER

No._____

IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1992

UNSECURED CREDITORS' COMMITTEE OF C-T OF VIRGINIA, INCORPORATED,
Petitioner.

v.

UNITED STATES OF AMERICA,
Respondent,

Petition for Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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APPENDIX

PUBLISHED
No. 91-2397

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

In re C-T OF VIRGINIA, INCORPORATED, d/b/a The Perfect Pair, d/b/a Comfort Unlimited, d/b/a The Shoe Room, d/b/a Herold's Shoes, d/b/a Country Cobbler, d/b/a Massey Shoes, d/b/a Bonafide Shoe Factory Outlet, d/b/a Hill Brothers, formerly known as Craddock-Terry Shoe Corporation,

Debtor.

UNITED STATES of America,

Plaintiff-Appellee,

v.

UNSECURED CREDITORS' COMMITTEE OF C-T OF VIRGINIA, INCORPORATED,

Defendant-Appellant.

Appeal from the United States District Court for the Western District of Virginia at Lynchburg
Jackson L. Kiser, District Judge
(CA-91-26-L, BK-687-01155)

Argued May 5, 1992
Decided Oct. 2, 1992
As Amended Nov. 3, 1992

Before, WIDENER and SPROUSE, Circuit Judges, and KAUFMAN, Senior United States District Judge for the District of Maryland, sitting by designation

Affirmed by published opinion. Senior Judge Kaufman wrote the opinion, in which judge Widener and Judge Sprouse joined.

Counsel

ARGUED: George H. Fralin, Jr., FRALIN, FREEMAN & KINNIER, P.C., Lynchburg, Virginia, for Appellant. Edward T. Perelmuter, Tax Division, UNITED STATES DEPARTMENT OF JUSTICE OF JUSTICE, Washington, D.C., for Appellee. ON BRIEF: Gary M. Coates, FRALIN, FREEMAN & KINNIER, P.C., Lynchburg, Virginia, for Appellant. James A. Bruton, Acting Assistant Attorney General, Gary R. Allen, Gary D. Gray, Tax Division, UNITED STATES DEPARTMENT OF JUSTICE OF JUSTICE, Washington, D.C., for Appellee. U.S. Dept. of Justice, Washington, D.C.; E. Montgomery Tucker, United States

Attorney, Roanoke, Virginia, for Appellee.

OPINION

KAUFMAN, Senior District Judge:

During a Chapter 11 bankruptcy proceeding instituted by C-T of Virginia, Inc. (C-T),[1] the Internal Revenue Service (IRS) filed an unsecured priority claim under Section 507(a)(7) of the Bankruptcy Code for taxes imposed pursuant to Title 26, Section 4980 of the United States Code ("retirement plan tax"),[2] in the amount of $285,443.35

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[1]C-T was formerly known as Craddock-Terry Shoe Corporation. The name of the debtor was changed to C-T of Virginia, Inc. during the pendency of the bankruptcy case.

[2]Section 4980 reads, in pertinent part:

> (a)There is hereby imposed a taxof 10 percent of the amount of any employer reversion from a qualified plan.

plus interest. Section 4980 imposed a tax upon an employer equal to 10 percent of the assets of a qualified pension

---

> (b) The tax imposed by subsection (a) shall be paid by the employer maintaining the plan.
>
> (c) For purposes of this section--
>
> > (1) The term "qualified plan" means any plan meeting the requirements of section 401(a) or 403(a), other than-
> >
> > > (A) a plan maintained by an employer if such employer has, at all times, been exempt from tax under subtitle A,
> > >
> > > (B) a governmental plan....
> >
> > Such term shall include any plan which, at any time, has been determined by the Secretary to be a qualified plan.
> >
> > (2)The term "employer reversion" means the amount of cash and the fair market value of other property received (directly or indirectly) by an employer from the qualified plan. 26 U.S.C. § 4980.

plan in the event the assets of the plan revert to the employer upon the plan's termination.[3]

The parties agree that C-T, within three years prior to the commencement of the bankruptcy case, terminated a qualified pension plan as defined under section 4980, and that, when the plan was terminated, C-T received the reversion referred to in section 4980. However, the Unsecured Creditors Committee, in connection with its duties with respect to the bankruptcy estate of C-T, objected to the IRS claim for the retirement plan tax, contending that that section imposes a penalty which is

---

[3]Section 4980 was amended in 1988 to increase the 10 percent tax to 15 percent, see Pub.L. No. 100-647, 102 Stat. 3704, and amended again in 1990 to increase the tax to 20 percent, see Pub.L. No. 101-508, 104 Stat. 1388 [1432].

not entitled to priority.[4] Agreeing with the Unsecured Creditors Committee, the Bankruptcy Court determined that the retirement plan tax pursuant to section 4980 was not entitled to priority because it is not an excise tax within the meaning of section 507(a)(7)(E)[5] nor

---

[4]Although, in the past, the Unsecured Creditors Committee objected to other aspects of the proofs of claim, all of those other objections were resolved by agreement during a hearing in the Bankruptcy Court. The parties have stipulated that the amount of retirement plan tax sought by the IRS is computed correctly. Thus, the only disputed issue is whether the IRS claim is entitled to priority in the C-T bankruptcy.

[5]Section 507(a)(7)(E) reads, in pertinent part:

> (a)The following expenses and claims have priority in the following order:
>
> . . .
>
> (7) Seventh, allowed unsecured claims of governmental units, only to the extent that such claims are for--
>
> . . .
>
> (E) an excise tax on--

a pecuniary penalty "in compensation for actual pecuniary loss" within the meaning of section 507(a)(7)(G),[6] but

---

> (i)a transaction occurring before the date of the filing of the petition for which a return, if required, is last due, under applicable law or under any extension, after three years before the date of the filing of the petition; or
>
> (ii) if a return is not required, a transaction occurring during the three years immediately preceding the date of the filing of the petition....

11 U.S.C. § 507(a)(7)(E).

[6]Section 507(a)(7)(G) reads, in pertinent part:

> (a) The following expenses and claims have priority in the following order:
>
> ....
>
> (7) Seventh, allowed unsecured claims of governmental units, only to the extent that such

rather was a punitive type of penalty which is not entitled to priority treatment in bankruptcy. Upon appeal, the district court reversed the decision of the Bankruptcy Court, determining that the retirement plan tax was a monetary imposition in the nature of an excise tax and was not a punitive penalty.

In New Neighborhoods, Inc. v. West Virginia Workers' Compensation Fund, 886 F.2d 714 (4th Cir. 1989), this Court addressed the characteristics governing whether an exaction is an excise tax

---

claims are for--

....

> (G) a penalty related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss.

11 U.S.C. § 507(a)(7)(G).

entitled to priority under section 507(a)(7)(E), and wrote, "[F]or the purposes of priority under the Bankruptcy Act, taxes include 'those pecuniary burdens laid upon individuals or their property, regardless of their consent, for the purpose of defraying the expenses of government or of undertakings authorized by it.' ", id. at 718 (quoting City of New York v. Feiring, 313 U.S. 283, 285 (1941), and also stated: "An excise tax is an indirect tax, one not directly imposed upon persons or property, and is one that is 'imposed on the performance of an act, the engaging in any occupation, or the enjoyment or[sic] a privilege.' " Id. at 719 (quoting In re Tri-Manufacturing & Sales Co., 82 B.R. 58, 60 (Bankr. S.D. Ohio 1988)). As to a punitive penalty, Judge Thomsen, in In

re Kline, 403 F. Supp. 974 (D. Md. 1975), aff'd, 547 F.2d 823 (4th Cir. 1977), observed: "An enactment which has as its purpose the punishment of conduct perceived as wrongful should be deemed a 'penalty' ... regardless of the terminology employed by the legislature." Id. at 978.

It is the purpose of the tax, not its name, which controls. While the name given by the legislative body may well be indicative of purpose, "[t]he name given to the exaction by the [federal Congress] is not conclusive." Id. (citing New Jersey v. Anderson, 203 U.S. 483 (1906). The tax at issue herein does not fall within the purview of section 507(a)(7)(G) as it is not exacted "in compensation for actual pecuniary loss." The sole issue is whether the tax falls under Section

507(a)(7)(E) as an excise tax or is a punitive penalty. The legislative history apparently gives little or no clue as to the answer to that question. Nor do the underlying background facts point conclusively in one direction or the other. When C-T, as the employer, contributed to the pension plan, it was able to deduct those contributions. When the plan was terminated, and the reversion occurred, the employer was required to pay tax on the reversion at a flat rate different from its then corporate rate, and not at the corporate rate at the time of the contribution and of the deduction. Rather clearly, the ten percent imposition hardly encourages the occurrence of such a reversion. But that does not necessarily mean that the imposition is a punitive type of penalty. The Bankruptcy Court concluded

that the exaction involved herein is aimed at seeking to reduce abuses by employers and analogized the exaction to certain other impositions which have been held not to be excise taxes for bankruptcy purposes.[7] In contrast, Judge

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[7]Thus Bankruptcy Court wrote:

> The debtor further contends that section 4980 is one of a series of statutes aimed at curbing employer abuses of employee benefit plans. See 26 U.S.C. §§ 4971-4981. See also 26 U.S.C. §§ 72(q), (t), and (v) which impose a 10% penalty or additional tax on premature distributions from annuity contracts, early distributions from qualified retirement plans, and taxable distributions from modified endowment contracts. The taxes imposed by section 4971 and 72(t) have been determined to be penalties rather than taxes. See In re Airlift Int'l, Inc., 97 B.R. 664 (Bkrtcy. S.D. Fla.1989), aff'd 120 B.R. 597 (S.D. Fla.1990) and In re Mansfield Tire & Rubber Co., 80 B.R. 395 (Bkrtcy. N.D. Ohio 1987),

Kiser, in the court below, referred to a number of instances in which what have been deemed excise taxes are purposed, at least in part, toward discouraging conduct,[8] but concluded that did not

---

aff'd 120 B.R. 862 (N.D. Ohio 1990) (section 4971 tax for failure to meet minimum plan funding standards construed as a penalty, not a tax for bankruptcy purposes); In re Cassidy, Jr., 91-1 (Bkrtcy. D. Colo. 1991) (11 U.S.C. § 72(t), which imposes a 10% tax U.S.T.C.early withdrawals from qualified retirement plans as defined in Section 4974(c), treated as a penalty not a tax).

In Re C-T of Virginia, Inc., No. 87-01155, slip op. at 6-7 (Bankr. W.D. Va. 1991).

[8]Judge Kiser thus noted:

> Many of the excise taxes of the Internal Revenue Code contained under Subtitles D (Miscellaneous Excise Taxes, which include § 4980) and E (Alcohol, Tobacco and Certain Other Excise Taxes) are levied against conduct and as such are consistent within the

prevent the imposition in question from

> parameters of New Neighborhoods. Such excise taxes encompass, inter alia, § 4064 (gas guzzler tax), § 4681 (tax on ozone-depleting chemicals), § 4702 (tax on "registration required" obligations issued in bearer form), § 4941 et seq. (tax on income, speculative investments, etc. of private foundations), § 4999 (tax on "golden parachute" payments), § 5881 (tax on "greenmail"). I find little to distinguish these sections of the code assessing excise taxes upon so a broad [sic] range of conduct from that of 26 I.R.C. § 4980 in which Congress has denominated an excise tax to be levied against an employer who receives a reversion of the assets of a qualified plan from whose tax-exempt status the employer has previously benefitted. I find that 26 I.R.C. § 4980 is a monetary exactment which more closely comports to the definition of an excise tax as articulated in New Neighborhoods and is not clearly a penalty as analyzed in Kline.

In re C-T of Virginia, Inc., No. 91-0026-L, slip op. at 4 (W.D. Va. Oct. 30, 1991).

being an excise tax entitled to priority treatment in bankruptcy. We agree with Judge Kiser. In our view the retirement plan tax in issue in this case, when viewed under the New Neighborhoods standards, has substantially more of the attributes of an excise tax than of a punitive penalty. Accordingly, we affirm the decision of the court below.

AFFIRMED.

IN THE UNITED STATES DISTRICT COURT FOR
THE WESTERN DISTRICT OF VIRGINIA

LYNCHBURG DIVISION

IN RE: Chapter 13
Case No
C-T VIRGINIA, INCORPORATED, 687-01155

Debtor.

UNITED STATES of America,

Appellant,

v. Civ.A. No.
91-0026-L.

UNSECURED CREDITORS' COMMITTEE
OF C-T OF VIRGINIA,

Appellee.

ORDER

For the reasons set forth in the Memorandum Opinion filed contemporaneously with this Order, it is ADJUDGED and ORDERED that the decision of the Bankruptcy Court is REVERSED and REMANDED to the Bankruptcy Court for

further proceedings consistent with the Memorandum Opinion.

The Clerk is directed to send a certified copy of this Order and the accompanying Memorandum Opinion to all counsel of record and to the Clerk of the Bankruptcy Court,

ENTER this 30th day of October, 1991.

/s/ Jackson L. Kiser
UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES DISTRICT COURT FOR
THE WESTERN DISTRICT OF VIRGINIA

LYNCHBURG DIVISION

IN RE:

C-T VIRGINIA, INCORPORATED,

Debtor.

Chapter 13
Case No
687-01155

UNITED STATES of America,

Appellant,

v.

UNSECURED CREDITORS' COMMITTEE
OF C-T OF VIRGINIA,

Appellee.

Civ.A. No.
91-0026-L.

MEMORANDUM OPINION
BY; Jackson L. Kiser, Judge
United States District Court

This matter is before me on appeal from the Bankruptcy Court. The United States of America has appealed the Bankruptcy Court's decision that the government's claim of an excise tax under 26 I.R.C. § 4980 is not entitled

to priority under § 507(a)(7)(E) of the Bankruptcy Code. Based upon an examination of the Bankruptcy Code, its legislative history and relevant case law, the decision of the Bankruptcy Court is reversed and the case remanded for proceedings consistent with this opinion.

BACKGROUND

The Internal Revenue Service filed as part of Claim No. 692 an unsecured priority claim under 11 U.S.C. § 507(a)(7) for $285,443.35 plus $1,788.37 interest. The claim is based upon 26 U.S.C. § 4980 which imposes an excise tax on an employer equal to 10% of the assets of a qualified pension plan when the assets of such plan revert to the employer. Within three years prior to the commencement of this case the debtor terminated a qualified

pension plan as defined in 26 U.S.C. § 4980(c)(1). When the plan was terminated the debtor received an employer reversion as defined in 26 U.S.C. § 4980(c)(2). The parties stipulated that the amount of the tax claimed by the Internal Revenue Service was computed correctly.

By its Order of May 3, 1991 the Bankruptcy Court determined that the tax claimed under § 4980 was not for the purpose of raising revenue or in compensation for actual pecuniary loss entitling the United States to priority, but was, instead, an exaction imposed as a penalty. This determination cannot be sustained.

DISCUSSION

At issue is whether a tax styled by Congress as an "excise tax" is automatically entitled to priority or

whether such tax may be independently analyzed, adjudged a penalty, and thereby be subordinated to the claims of other creditors under Section 507(a)(7)(E) of the Bankruptcy Code.

Section 507(a)(7)(E) of the Bankruptcy Code allows for priority payment on:

> (E) an excise tax on--
>
> (i) a transaction occurring before the date of the filing of the petition for which a return, if required, is last due, after three years before the date of the filing of the petition; or
>
> (ii) if a return is not required, a transaction occurring during the three years immediately preceding the date of the filing of the

petition;

Relying upon In re: Mansfield Tire & Rubber Co., 80 B.R. 395 (Bankr. N.D. Ohio 1987), aff'd, 120 B.R. 862 (N.D. Ohio 1990) the Bankruptcy Court accepted the argument of the Creditors' Committee of C-T of Virginia in finding that the government's claim under 26 I.R.C. § 4980 was not a tax imposed for the purpose of raising revenue, but was instead, within the meaning of Mansfield, an exaction as "punishment for an unlawful act." Id. Subsequent to the Bankruptcy Court's ruling, the Court of Appeals for the Sixth Circuit reversed Mansfield and held that courts are not free to look behind the designation given a federal exaction by Congress when determining priority under the Bankruptcy Code. United States v. Mansfield Tire and Rubber Co., --F.2d--,

1991 WL 163767 (6th Cir. Aug. 28, 1991).

The approach adopted by the Bankruptcy Court, however, is not inconsistent with that employed by the Fourth Circuit. I disagree not with the Bankruptcy Court's methodology but with its conclusion.

The Fourth Circuit affords priority to "those pecuniary burdens laid upon individuals or their property, regardless of their consent, for the purpose of defraying the expenses of government or of undertakings authorized by it." New Neighborhoods v. West Virginia Workers' Comp. Fund., 886 F.2d 714, 718 (4th Cir. 1989) citing City of New York v. Feiring, 313 U.S. 283, 285 (1941). New Neighborhoods defines an excise tax as "an indirect tax, one not directly imposed upon persons or property [citation omitted], and is one

that is 'imposed on the performance of an act, the engaging in any occupation, or the enjoyment or [sic] a privilege.'" Id. at 719 [citation omitted]. The name given to the exaction by a legislative body is not conclusive, however, even when that legislative body is the United States Congress. See Matter of Kline, 403 F. Supp. 974, 978 (Md. 1975) aff'd, 547 F.2d 823 (4th Cir. 1977). In Kline the court held that a "tax" imposed for self dealing upon a manager of a tax exempt private foundation on balance had more of the attributes of a penalty than of a tax. By a similar analysis, I find the excise tax under 26 I.R.C. § 4980, imposed upon C-T of Virginia on the assets it received in the reversion of its terminated qualified plan partake substantially more of the attributes of an excise tax than of a penalty.

Many of the excise taxes of the Internal Revenue Code contained under Subtitles D (Miscellaneous Excise Taxes, which include § 4980) and E (Alcohol, Tobacco and Certain Other Excise Taxes) are levied against conduct and as such are consistent within the parameters of New Neighborhoods. Such excise taxes encompass, inter alia, § 4064 (gas guzzler tax), § 4681 (tax on ozone-depleting chemicals), § 4702 (tax on "registration required" obligations issued in bearer form), § 4941 et seq. (tax on undistributed income, speculative investments, etc. of private foundations), § 4999 (tax on "golden parachute" payments), § 5881 (tax on "greenmail"). I find little to distinguish these sections of the code assessing excise taxes upon so a broad range of conduct from that of 26 I.R.C.

§ 4980 in which Congress has denominated an excise tax to be levied against an employer who receives a reversion of the assets of a qualified plan from whose tax-exempt status the employer has previously benefitted. I find that 26 I.R.C. § 4980 is a monetary exactment which more closely comports to the definition of an excise tax as articulated in New Neighborhoods and is not clearly a penalty as analyzed in Kline.

CONCLUSION

For the reasons stated above, the decision of the Bankruptcy Court is reversed as to its holding that 26 I.R.C. § 4980 constitutes a penalty for purposes of priority under 11 U.S.C. § 507(a)(7)(E).

/s/ Jackson L. Kiser
UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF VIRGINIA
LYNCHBURG DIVISION

IN RE: Case No. 87-01155

C-T OF VIRGINIA, INCORPORATED, fka Craddock-Terry Shoe Corporation f/d/b/a Hill Brothers, Bonafide Shoe Factory Outlet, Massey Shoes, Country Cobbler, Herold's Shoes, The Shoe Room, Comfort Unlimited, and The Perfect Pair,

Debtor.

ORDER

For the reasons expressed in the accompanying Memorandum Opinion, it is hereby

ORDERED and ADJUDGED

that the $285,443.35 plus $1,788.37 pre-petition interest claimed as an unsecured priority claim by the Internal Revenue Service as part of Claim No. 692 filed in the case is not entitled to priority under 11 U.S.C. §§507(a)(7)(E)

or (G).

The Clerk shall distribute copies of this Order to: George H. Fralin, Jr., Esq., Counsel for Unsecured Creditors' Committee; Joseph Braunstein, Esq., Counsel for Creditors' Committee; U. S. Department of Justice, Tax Division, Attention: Gerald A. Role, Esq.; U.S. Attorney's Office, Roanoke, Virginia; and U. S. Trustee's Office.

Entered: May 3, 1991
/s/ William E. Anderson
Chief Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF VIRGINIA
LYNCHBURG DIVISION

IN RE:

Case No.
87-01155

C-T OF VIRGINIA, INCORPORATED,
fka Craddock-Terry Shoe Corporation
f/d/b/a Hill Brothers, Bonafide
Shoe Factory Outlet, Massey
Shoes, Country Cobbler, Herold's
Shoes, The Shoe Room, Comfort Unlimited,
and The Perfect Pair,

Debtor.

MEMORANDUM OPINION

The issue before the court is whether a tax imposed on C-T of Virginia, Inc., the debtor, pursuant to 26 U.S.C. §4980 is entitled to priority under section 507 of the Bankruptcy Code. If the obligation is properly categorized as an excise tax or as a pecuniary penalty, it will be entitled to priority status pursuant to 11 U.S.C. §507(a)(7)(E) or (G) and must be paid in full with interest before the debtor's unsecured creditors If it is determined

to be a punitive penalty, however, the liability imposed pursuant to section 4980 will not be afforded priority treatment.

FACTS

The parties stipulated the following facts. The Internal Revenue Service filed as part of Claim No. 692 an unsecured priority claim under 11 U.S.C. §507(a)(7) for $285,443.35 plus $1,788.37 interest. The claim is based on 26 U.S.C. §4980[1], which imposes a tax

---

[1]26 U.S.C. §4980 provides in relevant part as follows:

(a)Imposition of Tax.--There is hereby imposed a tax of 10 percent of the amount of any employer reversion from a qualified plan.

(b)Liability for Tax.--The tax imposed by subsection (a) shall be paid by the employer maintaining the plan.

(c)Definitions and Special Rules.--For purposes of this section--

(1)Qualified Plan.--The term

on an employer equal to 10% of the assets of a qualified pension plan when the assets of such a plan revert to an employer. Within three years prior to the commencement of this case the debtor terminated a qualified pension plan as defined in 26 U.S.C. §4980(c)(1). When the plan was terminated the debtor received an "employer reversion" as defined in 26 U.S.C. §4980(c)(2). The amount of tax claimed by the Internal

---

"qualified plan" means any plan meeting the requirements of section 401(a) or 403(a), other than--...

Such term shall include any plan which, at any time, has been determined by the Secretary to be a qualified plan.

(2) Employer reversion.--

(A)In general.--The term "employer reversion" means the amount of cash and the fair market value of other property received (directly or indirectly) by an employer from the qualified plan.

. . .

Revenue Service was computed correctly.

ARGUMENTS

The Unsecured Creditors' Committee argues on behalf of the debtor that the tax on reversions of qualified pension plan assets imposed by section 4980 is a penalty, not a tax entitled to priority under section 507(a)(7)(E) of the Bankruptcy Code, and that it is not a penalty afforded priority under section 507(a)(7)(G).[2]

---

[2] 11 U.S.C. §507(a)(7)(E) and (G) provide:

> (a) The following expenses and claims have priority in the following order:
>
> (7) Seventh, allowed unsecured claims of governmental units, only to the extent that such claims are for--
>
> (E) an excise tax on--
>
> (i) a transaction occurring before the date of the filing of the

The United States of America argues that the tax imposed by section 4980 is an excise tax entitled to priority under section 507(a)(7)(E) because: (1) it was added to the Internal Revenue Code by section 1132 of the Tax Reform Act of 1986, Pub. L. No. 99-514, which is entitled "excise tax on reversion of qualified plan assets to employer;" (2)

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petition for which a return, if required, is last due, under applicable law or under any extension, after three years before the date of the filing of the petition; or

(ii) if a return is not required, a transaction occurring during the three years immediately preceding the date of the filing of the petition; ...; or

(G) a penalty related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss.

the legislative history of section 4980 indicates that the tax imposed by section 4980 is a tax and not a penalty; and (3) that section 4980 satisfies the judicial test for treatment as a tax for bankruptcy purposes.

DISCUSSION

The name given to an obligation imposed under the Internal Revenue Code does not determine whether it is should be categorized as a tax or a penalty for purposes of section 507 of the Bankruptcy Code. See New Neighborhoods, Inc. v. West Virginia Workers' Compensation Fund, 886 F.2d 714, 718 (4th Cir. 1989); In re Kline, 403 F.Supp. 974, 978 (D. Md.1975), aff'd 547 F.2d 823 (4th Cir. 1977); In re Airlift Int'l, Inc., 97 B.R. 664, 669 (Bkrtcy.S.D.Fla.1989), aff'd 120 B.R.

597 (S.D. Fla.1990).

Instead, a four factor test is used to determine whether an obligation is considered a tax entitled to priority. An obligation is a tax if it is: (1) an involuntary pecuniary burden, regardless of name, laid upon individuals or property; (2) imposed by or under the authority of the legislature; (3) for public purposes, including the purposes of defraying expenses of government or undertakings authorized by it; and (4) under the police or taxing power of the government. City of New York v. Feiring, 313 U.S. 283, 285, (1941); In re Mansfield Tire & Rubber Co., 80 B.R. 395, 397 (Bkrtcy.N.D.Ohio 1987), aff'd 120 B.R. 862 (N.D.Ohio 1990). Although the obligation imposed by section 4980 arguably satisfies the first, second, and fourth factors, no court has yet

determined that the "employer reversion tax" was imposed by Congress for the purpose of raising revenue or any other public purpose.

The United States argues that the "employer reversion tax" is for a public purpose because section 4980 recaptures the tax on income which would have been imposed had the employer not contributed it to a qualified defined benefit plan. The United States goes on to argue that the tax is an enforced contribution to provide for the support of the government like the corporate income tax. When a plan is terminated and a reversion occurs, instead of going back and revising corporate income and recomputing the corporate income for each year that contributions to the defined benefit plan were made, the reversion amount is taxed at a flat rate

when it is received. Finally, the United States argues that a uniform tax rate was imposed rather than a graduated rate like that used for computing corporate income tax, in order to avoid overly complex computations to determine the amount of tax due when reversions occur.

The debtor points out that the tax imposed by section 4980 on pension plan assets when they revert to an employer is in addition to, not in lieu of, the corporate income tax.[3] Nor is the amount due under section 4980 related to any tax benefit enjoyed by the employer.[4] Instead, the purpose of

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[3]26 U.S.C. §§61, 111; Regulation §1.111-1; and Rev.Rul. 73- 528, 1973-2 C.B. 13.

[4]For example, the debtor points out that there is no relationship between the Section 4980 tax rate and the corporate income tax rates imposed by 26 U.S.C.

section 4980 is to recapture unintended tax advantages and to reverse inappropriate tax-favored treatment.

The debtor further contends that section 4980 is one of a series of statutes aimed at curbing employer abuses of employee benefit plans. See 26 U.S.C. §§4971-4980B. See also 26 U.S.C. §§72(q), (t), and (v) which impose a 10% penalty or additional tax on premature distributions from annuity contracts, early distributions from qualified retirement plans, and taxable

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§11(b). Section 4980 went into effect January 1, 1986 at a 10% flat rate. Pub.L. 99-514, Section 1132. At that time the top corporate income tax rate was 46%, Pub.L. 95-600, Section 301(a). The top corporate income tax rate was reduced to 34% effective July 1, 1987, Pub.L. 99-514, Section 601. Effective October 20, 1988, the rate of tax imposed by Section 4980 was increased to 15%, Pub.L. 100-647, and further increased to either 20% or 50% effective October 1, 1990, Pub.L.__-__.

distributions from modified endowment contracts. The taxes imposed by section 4971 and 72(t) have been determined to be penalties rather than taxes. See In re Airlift Int'l, Inc., 97 B.R. 664 (Bkrtcy.S.D.Fla.1989), aff'd 120 B.R. 597 (S.D.Fla.1990) and In re Mansfield Tire & Rubber Co., 80 B.R. 395, aff'd 120 B.R. 862 (N.D.Ohio 1990) (section 4971 tax for failure to meet minimum plan funding standards construed as a penalty, not a tax for bankruptcy purposes); In re Cassidy, Jr., 91-1 U.S.T.C. (Bkrtcy.D.Colo.1991) (11 U.S.C. §72(t), which imposes a 10% tax against early withdrawals from qualified retirement plans as defined in Section 4974(c), treated as a penalty not a tax).

Nothing in the legislative history of 26 U.S.C. §4980 specifically

addresses the penalty versus excise tax question that is before the court. In general, however, that history and other legal commentary indicates that the purpose of section 4980 was and is to discourage employers from terminating overfunded retirement plans and using the excess funds for purposes other than employee retirement, health or other benefits.[5]

The court therefore agrees with the debtor that the obligation imposed by

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[5]See, e.g., "General Explanation of the Tax Reform Act of 1986 (HR 3838)," prepared by the Staff of the Joint Committee on Taxation and released May 7, 1987, pp. 750-54; House Ways and Means Committee Report on HR 3838, "Tax Reform Act of 1985," Part II, released Dec. 9, 1985, pp. 756- 57; and Treasury Department Report to President Reagan on "Tax Reform for Fairness, Simplicity, and Economic Growth--Vol. 2--General Explanation of the Treasury Department Proposals," Chapter 17.05, Nov. 27, 1984.

section 4980 is not a typical excise tax like those imposed on sales, gasoline, or estates and gifts which were clearly given priority by 11 U.S.C. §507(a)(7)(E)[6]. The question remains, however, whether it should be categorized as a pecuniary loss penalty entitled to priority status pursuant to 11 U.S.C. §507(a)(7)(G).

Section 507(a)(7)(G) gives priority status to unsecured claims of governmental units to the extent that such claims are for a penalty related to a claim of a kind otherwise specified in section 507(a)(7) and are in compensation for actual pecuniary loss. The obligation imposed by 26 U.S.C. s 4980 does not seem to meet either

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[6]See the legislative history of section 507(a)(7)(E) at S.Rep.No. 989, 95th Cong., 2d Sess. 71 (1978).

requirement.

As set out above, it does not qualify as a tax claim under 11 U.S.C. §507(a)(7)(E) or any other section, nor is it related to any such claim.

Nor does it seem intended to compensate the government for actual pecuniary loss. The obligation that arises under section 4980 is imposed whether or not there has been any loss to the government. As the debtor notes, section 4980 imposes an obligation upon, and the same rate applies to, the reversion amount even though the employer may not have realized any tax benefit at the time it made contributions to the pension plan or even if the funds in the plan did not generate earnings that would have been taxable. The debtor's conclusion that Congress never intended that section

4980 recoup the actual amount of pecuniary loss to the government seems accurate.

CONCLUSION

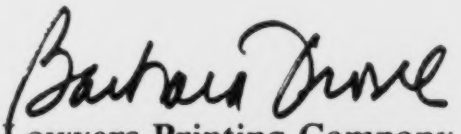
For the reasons set forth above, this court holds that that part of Claim No. 692 filed in this case by the Internal Revenue Service as an unsecured priority claim in the amount of $285,443.35 plus $1,788.37 pre-petition interest is not entitled to priority under 11 U.S.C. §§507(a)(7)(E) or (G). The court, without ruling thereon, also acknowledges that the Unsecured Creditors' Committee has the right to file a motion on behalf of the debtor seeking subordination of the amount claimed to other unsecured claims.

/s/ William E. Anderson
Chief Judge

Dated: May 3, 1991

FILING CERTIFICATE

I hereby certify that on this 30th day of December, 1992, I filed 40 copies of a Petition for Writ of Certiorari with the Clerk's Office of the Supreme Court of the United States via first class mail, postage prepaid. The necessary filing and mailing was performed in accordance with the instructions given me by counsel in this case.



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In the Supreme Court of the United States

OCTOBER TERM, 1992

UNSECURED CREDITORS' COMMITTEE OF C-T OF VIRGINIA, INCORPORATED, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the excise tax imposed under Section 4980 of the Internal Revenue Code, 26 U.S.C. 4980, is entitled to priority in distribution of a bankruptcy estate as an "excise tax" under Section 507(a)(7)(E) of the Bankruptcy Code, 11 U.S.C. 507(a)(7)(E).

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In the Supreme Court of the United States

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v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A15) is reported at 977 F.2d 137. The opinion of the district court (Pet. App. A18-A26) is reported at 135 Bankr. 501. The memorandum opinion of the bankruptcy court (Pet. App. A29-A43) is reported at 128 Bankr. 628.

JURISDICTION

The judgment of the court of appeals was entered on October 2, 1992. The petition for a writ of certiorari was filed on December 31, 1992. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. C-T of Virginia, Inc., is a Virginia corporation engaged in the manufacture and wholesale and mail-order sale of shoes. In 1986, the company terminated a qualified pension plan and received a reversion of plan assets. The reversion resulted in the imposition of an excise tax under Section 4980 of the Internal Revenue Code which, in 1986, imposed an excise tax of 10% of the amount of assets that reverted to the employer. 26 U.S.C. 4980 (Supp. IV 1986). The excise tax thus assessed was $285,443.35 (Pet. App. A19).

After this assessment was made, C-T filed a petition for relief under Chapter 11 of the Bankruptcy Code. During the course of the bankruptcy proceeding, the Internal Revenue Service (IRS) filed an unsecured priority claim for the amount of the unpaid excise tax plus interest under Section 507(a)(7)(E) of the Bankruptcy Code, 11 U.S.C. 507(a)(7)(E). That Section establishes a priority for excise taxes on transactions that (i) occur before the date of the filing of the petition and for which a return was due within three years of the filing or (ii) occur within three years of the filing of the petition if no return is required. 11 U.S.C. 507(a)(7)(E). The Unsecured Creditors' Committee of C-T filed an objection to the government's priority claim, contending that the excise tax was a "penalty" that was not entitled to priority in distribution of the bankruptcy estate (Pet. App. A5-A6).

The bankruptcy court held that the IRS's claim was not entitled to priority (Pet. App. A43). The court held that the name given to an exaction under the Internal Revenue Code is not dispositive for bankruptcy purposes (Pet. App. A34). The court concluded that the legislative history of Section 4980 indicated that the excise tax under that Section was designed to discourage employers from terminating overfunded retirement plans and using

the excess funds for purposes other than employee benefits (Pet. App. A40). As a result, the court held that the exaction "is not a typical excise tax like those imposed on sales, gasoline, or estates and gifts which were clearly given priority by 11 U.S.C. § 507(a)(7)(E)" (Pet. App. A41).[1]

2. The district court reversed (Pet. App. A18-A26). The district court stated that it agreed that the congressional designation of the Section 4980 exaction as an "excise tax" is not dispositive of the priority issue under the Bankruptcy Code (Pet. App. A23). The court observed, however, that the Fourth Circuit had defined an excise tax for purposes of Section 507(a)(7)(E) of the Bankruptcy Code as a "pecuniary burden[] laid upon individuals or their property, regardless of their consent, for the purpose of defraying the expenses of government or of undertakings authorized by it" (Pet. App. A23) (quoting *New Neighborhoods, Inc.* v. *West Virginia Workers' Comp. Fund*, 886 F.2d 714, 718 (4th Cir. 1989)).[2] The court held that the Section 4980 exaction comports with this standard and is therefore properly classified as an "excise tax," rather than as a "penalty," for bankruptcy priority purposes (Pet. App. A26).

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[1] The bankruptcy court further held that the government's claim was not entitled to priority under 11 U.S.C. 507(a)(7)(G), which awards priority to claims for penalties that compensate for pecuniary losses (Pet. App. A41-A43). That issue was not addressed by either the district court or the court of appeals.

[2] This standard is derived from *City of New York* v. *Feiring*, 313 U.S. 283 (1941), a case under the former Bankruptcy Act. The issue in *Feiring* was whether a municipal sales tax was a "tax" entitled to priority under Section 64a(4) of the Bankruptcy Act or was a "debt" that was not entitled to priority. The *Feiring* case did not provide a definition of an "excise tax" for bankruptcy priority purposes. Indeed, the former Bankruptcy Act, unlike the current Bankruptcy Code, did not contain a provision expressly awarding priority to "excise taxes."

3. The court of appeals affirmed (Pet. App. A1-A15). The court stated that the priority question under the Bankruptcy Code is controlled by the purpose, and not the name, of the exaction (Pet. App. A10). The court held that the Section 4980 exaction "has substantially more of the attributes of an excise tax than of a punitive penalty" (Pet. App. A15) and is therefore entitled to priority under the Bankruptcy Code.

ARGUMENT

The court of appeals correctly held that the excise tax imposed by Section 4980 of the Internal Revenue Code is entitled to priority under Section 507(a)(7)(E) of the Bankruptcy Code. The decision of the court of appeals does not conflict with any decision of this Court or of any other court of appeals. Further review is therefore not warranted.

1. We do not agree with the analysis applied by the court of appeals in this case. Under the court's analysis, a federal excise tax will be entitled to priority in distribution of a bankruptcy estate only if the principal purpose of the exaction is revenue enhancement and not deterrence of socially undesirable conduct. But the Bankruptcy Code priority is for any "excise tax," *whatever* purpose Congress may have had in mind in enacting such a tax.[3] By the plain words of the statute, any federal "excise tax" is entitled to priority under Section 507(a)(7)(E) of the Bankruptcy Code. See *In re Mansfield Tire & Rubber Co. (United States* v. *Mansfield Tire & Rubber Co.*), 942 F.2d 1055 (6th Cir. 1991), cert. denied, 112 S. Ct. 1165 (1992). When Congress grants a bankruptcy priority for any "excise tax," and designates

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[3] Excise taxes generally discourage (or "penalize") to some extent the activity that is taxed. We have federal excise taxes on tobacco and liquor, not on bread and milk. That fact does not make excise taxes "penalties."

a particular exaction as an "excise tax," it is not the courts' function to disregard the precise words that Congress has employed. Our disagreement with the reasoning of the court of appeals, however, is of no consequence in this case, for the court correctly held that the excise tax under Section 4980 of the Internal Revenue Code is entitled to priority under the test the court chose to apply.

Congress enacted Section 4980 of the Internal Revenue Code as part of the Tax Reform Act of 1986, Pub. L. No. 99-514, § 1132(a), 100 Stat. 2478. As enacted, the provision imposed a nondeductible 10% excise tax based on the value of assets in a qualified pension plan that reverted to an employer upon termination of the plan. 26 U.S.C. 4980(a) (Supp. IV 1986).[4] The Committee Reports explained the provision as follows:

> The committee believes that it is appropriate to limit the tax incentives available for retirement savings provided through defined benefit pension plans to the amount actually applied to provide retirement income. To the extent that amounts in such plans are not used for retirement purposes and revert to an employer, the committee believes that the tax treatment of reversions should recognize that the tax on earnings on pension funds is deferred and, thus, the benefits of this tax treatment should be recaptured. Although the committee believes that it might be possible to determine the particular year or years in

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[4] The excise tax was increased to 15% in 1988 (Technical and Miscellaneous Revenue Act, Pub. L. No. 100-647, § 6069(a), 102 Stat. 3704) and to 20% in 1990 (Omnibus Budget Reconciliation Act, Pub. L. No. 101-508, § 12001, 104 Stat. 1388-562). The 1990 amendment also provided that the excise tax would be imposed at a 50% rate unless the employer established or maintained a qualified replacement plan. Omnibus Budget Reconciliation Act, § 12002(a), 104 Stat. 1388-562.

> which contributions resulting in a reversion arose and to recoup the resulting tax benefit attributable to a reversion on that basis, the committee is concerned that such a computation would involve undue complexity. Under the circumstances, therefore, the committee determined that a nondeductible excise tax should be imposed on reversions at a uniform rate.

S. Rep. No. 313, 99th Cong., 2d Sess. 636 (1986); H.R. Rep. No. 426, 99th Cong., 1st Sess. 756 (1985).

As these reports indicate, the principal purpose of the Section 4980 excise tax was to recoup the tax benefits obtained during the existence of a qualified pension plan upon termination of the plan. The exaction imposed against C-T under Section 4980 was designed to recover tax benefits that the government had allowed while the company's pension plan was in existence. The legislative history does not support petitioner's contention (Pet. 27) that Congress's primary purpose in enacting Section 4980 was to punish employers who engaged in socially undesirable conduct.[5]

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[5] Petitioner's reliance (Pet. 23-27) on the legislative history accompanying the enactment of *subsequent* versions of Section 4980 in attempting to establish the purpose of Congress in enacting the 1986 version of the statute is inappropriate. Cf. *Pierce* v. *Underwood*, 487 U.S. 552, 566-567 (1988). The fact that the Treasury Report to the President (Pet. 22-24), which was issued two years prior to the enactment of Section 4980, indicated that the provision would have the salutary *effect* of deterring abuses of qualified pension plans, does not establish that deterrence was the *primary purpose* of the provision. As this Court has emphasized, "the authoritative source for finding the Legislature's intent lies in the Committee Reports on the bill" (*Garcia* v. *United States*, 469 U.S. 70, 76 (1984)). As discussed in the text, those reports do not support petitioner's contention that the primary purpose of the 1986 version of Section 4980 was to punish socially undesirable conduct.

2. The decision of the court of appeals does not conflict with *In re Kline (United States v. Feinblatt)*, 403 F. Supp. 974 (D. Md. 1975), aff'd, 547 F.2d 823 (4th Cir. 1977), and *In re Unified Control Systems, Inc. (Mahon* v. *United States Internal Revenue Serv.)*, 586 F.2d 1036 (5th Cir. 1978), as petitioner contends (Pet. 31-32). *Kline* and *Unified Control* involved the excise taxes imposed upon prohibited activities involving private foundations. The issue before the courts of appeals in those cases was whether the government's claim was entitled to fourth priority in distribution as a "tax" under Section 64a of the former Bankruptcy Act or was to be disallowed in its entirety as a "penalty" under Section 57j of that Act. The courts applied the same test adopted by the Fourth Circuit in this case in concluding that the exactions were "penalties." See 403 F. Supp. at 978-979 (noting that the "sole substantial purpose" of the excise taxes imposed by Sections 4941 and 4944 of the Internal Revenue Code was to penalize wrongful conduct); 586 F.2d at 1039 (concluding that the excise taxes imposed by Sections 4941(a)(1) and 4941(b)(2) "were intended to curb the described conduct through pecuniary punishment"). The decisions in *Kline* and *Unified Control* do not conflict with the decision in this case because those cases involved different tax provisions and different priority provisions from those at issue in the present case—provisions to which the courts in those cases applied the same legal standard on which the courts below relied in this case.

3. The decision in this case also does not conflict with the Tenth Circuit's recent decision in *In re Cassidy (United States* v. *Dumler)*, 983 F.2d 161 (1992). The issue in *Cassidy* was whether the additional income tax imposed by Section 72(t) of the Internal Revenue Code against individuals who receive an early distribution from a qualified retirement plan is entitled to priority as

"a tax on or measured by income" under Section 507(a)(7)(A) of the Bankruptcy Code. The Tenth Circuit, applying the same test applied by the Fourth Circuit in this case, concluded that the history of the Section 72(t) exaction reflected that it was primarily designed to punish socially undesirable conduct and was thus a "penalty" rather than a "tax." By contrast, the legislative history of Section 4980 reflects that the exaction under that Section was primarily designed to recapture tax benefits associated with the existence of a qualified pension plan. See pp. 5-6, *supra*. The decision in *Cassidy* is thus inapposite to this case.

4. The fact that different rationales were employed in this case and in *In re Mansfield Tire & Rubber Co.*, *supra*, does not provide a basis for further review. Under the reasoning of the Sixth Circuit in *Mansfield Tire*, an "excise tax" is entitled to priority because Congress has enacted it as an "excise tax." Under the reasoning of the Fourth Circuit in this case, the excise tax under Section 4980 is entitled to priority because it was not primarily designed to punish socially undesirable conduct. The result is the same under either approach.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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MARCH 1993